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Supreme Court of the United States

OCTOBER TERM, 1934.

No. 625.

REALTY ASSOCIATES SECURITIES CORPORATION and REALTY ASSOCIATES, INC.,

Petitioners,

—against—

EUGENE F. O'CONNOR, JR., FRED L. GROSS, HOMER E. PALMER, *et al.*,

Respondents.

BRIEF FOR RESPONDENT EUGENE F. O'CONNOR, JR.

Statement.

This court has already denied certiorari in the bankruptcy proceeding from which the pending application arises on the issue of the power of the court under the bankruptcy statute to allow compensation to counsel for a bondholders' committee.[1] The circuit court affirmed the district court in refusing to confirm a bankruptcy composition with an agreement to compensate counsel for three separate bondholders' committees.

Objection to Jurisdiction.

Pursuant to Rule 7, Subdivision 3 of this Court for failure of petitioners to comply with Rule 10, Subdivision 3, respondent objects to the entertaining of this applica-

[1] *Bondholders' Committee, etc., v. Realty Associates Securities Corporation, et al.*, 292 U. S. 628 (1934).

tion on the ground that petitioners have omitted to make a part of the transcript of record before this Court, the trust indenture dated July 10, 1933 between Realty Associates Securities Corporation, the bankrupt, and Manufacturers Trust Company, trustee, which defines the terms of settlement here involved (R. 11, fol. 32). This indenture was handed up in printed form to the circuit court on the argument of the appeal (R. 140) and is expressly referred to in the order under review (R. 89, fol. 265).

Its terms are essential for a proper understanding of the issues here presented, particularly as to whether creditors received old or new bonds. See Petitioners' Fourth Specification of Error, page 6, and comment of Judge Chase in the circuit court (R. 156, fol. 468; R. 157, fol. 469) referring especially to a "rider", the terms of which are contained only in the indenture to which respondent is precluded from making reference hereinafter, in view of the incomplete record.

The Facts.

The opinion of Judge Chase (R. 151-160) gives a succinct and accurate statement of the facts, which will not be here repeated.

The Issue.

The record below presented for review the following question of law:

> In a composition in bankruptcy where the liabilities total $13,008,038.33 and creditors are to be paid 100%, are the referee's commissions, as prescribed by §40-a (11 USCA 68a) of the Bankruptcy Act, to be computed on the total claims $13,008,038.33 as "the amount to be paid to the creditors" or $4,812,974.17?

Fees of referees are not paid on a salary basis but are arbitrarily regulated by the bankruptcy statute. In case of a composition they are fixed at

> "one-half of one per centum on the amount to be paid to the creditors upon the confirmation of a composition" (§40-a, 11 U.S.C.A. 68-a).

The authorities universally hold and Circuit Judge A. N. Hand agrees that:

> "It is perfectly true that referee's commissions have ordinarily been figured upon the par value of notes that have been offered by a bankrupt in a composition * * *" (R. 161).

POINTS.

I.

This Court by new General Order XLVIII has recently recognized that the measure of referee's compensation is not what creditors ultimately receive but the amount promised to be paid by the debtor.

Under date of April 17th, 1933 this Court promulgated additional general orders in connection with proceedings under §74 (11 U.S.C.A. 202) of the bankruptcy act regulating extensions. Subdivision 4 of new General Order XLVIII bears on the question of "the amount to be paid creditors". It is significant that even in the instance of an extension where no cash is to be paid, this Court has ordered that "the amount of the debts whose maturity is to be extended * * * shall be deemed to be 'the amount to be paid creditors'."

The relevant portion of the general order follows:

> "4. For the purposes of computing the commissions *of the referee*[2] and of the custodian or re-

[2] Italics throughout this brief unless otherwise indicated are the writer's.

> ceiver the term 'composition' as used *in sections 40* and 48 of the Act shall be deemed to include an extension proposal, *and the amount of the debts whose maturity is to be extended thereunder* and of the debts, if any, to be paid in full on the confirmation, shall be deemed to be 'the amount to be paid creditors' within the meaning of said sections."

In making this rule this Court took cognizance of sound precedent and in the language of Judge Chase rejected a principle "making the amount of the referee's compensation contingent upon the probability of the fulfillment of the bankrupt's promises to make the deferred payments" (R. 159).

This the Court was constrained to do in the face of the construction given the statute by well-recognized authority, never questioned in any court. Text writers[3] on bankruptcy have accepted the following reasoning of Circuit Judge Ward enunciated in 1916:

> "Likewise he (the referee) would not be prejudiced if the creditors had accepted, instead of cash, notes of the alleged bankrupt in settlement *which were never paid*, or if they had released the alleged bankrupt in consideration of receiving notes or property from some other person." *In re Batterman* (C. C. A. 2, 1916) 231 Fed. 699, 700.

That this has been the prevailing and accepted rule for many years, Judge L. N. Hand, in his dissenting opinion concedes, (R. 161) referring to a rule binding on respondent during his experience as referee for twenty years.

In promulgating the new general order this Court gave approval to existing authority as exemplified by *Kinkead v. J. Bacon & Sons* (C. C. A. 6, 1916), 230 Fed. 362 (cer-

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[3] Collier on Bankruptcy, Vol. I (13th ed. 1923), page 982.

tiorari denied 241 U. S. 680). Knappen, C. J., writing for that Court held (230 Fed. at 366):

> "But the 'consideration to be paid by the bankrupt to his creditors' *may or may not be cash.* A bankrupt usually does not have enough ready money of his own to carry out a composition. The 'consideration to be paid' may be the bankrupt's notes, secured or even wholly unsecured *or his mere promise to pay* in the future a given amount. 2 Loveland on Bankruptcy (4th Ed.), p. 1264. It is common knowledge that compositions sometime contemplate the taking by creditors of stock or securities under a reorganization, as in the arrangement under consideration in *Re Kinnaue* (D. C.), 221 Fed. 762."

The compensation provided by the new general order was the only possible standard because even before the enactment of the extension statute, the composition section contemplated settlements other than cash. The act provides that upon confirmation of the composition, the bankrupt shall be discharged "*from his debts, other than those agreed to be paid* by the terms of the composition" (§14c, 11 U. S. C. A. 32c). For a holding that "agreed to be paid" means notes and not only cash see *In re Mirkus*, 289 Fed. 732 (C. C. A. 2) per Hough, C. J.

It will be observed that the bankrupt has, in effect upon payment of 15% on account, obtained an extension of the maturity date as to the balance of its debt. At the time, as petitioner concedes, (p. 3) the company had liquid assets of $3,331,295.72 in addition to real estate interests of the book value of $13,401,862.62 (R. 7) to meet creditors' claims of $13,008,038.30. In other words from its liquid assets alone, the company could pay a cash dividend to creditors of 25.61 per cent. Petitioners' statement that the remaining assets "if liquidated" • • • "would net a very small amount of money" (p. 4) is supported by nothing in the record.

II.

There is no necessity for review by this tribunal because five circuit courts have held without disagreement that a referee's compensation is arbitrarily fixed by statute with no room for judicial discretion.

There is no conflict, as is claimed, among any of the circuits on the question here involved.

This case involves merely the application of the statutory mathematical formula of one-half of one per cent. times the amount of claims filed. For reasons of policy, which have been well stated,[4] the statute is rigid and mandatory.

As indicated by Circuit Judge Woolley, in 1915:

> "* * * Congress intended by the amendments to Section 40a * * * and by Section 72, to relieve the courts of the necessity of determining what constitutes legal compensation for those officers."[5]

The language of Judge Chase in the case at bar represents the true state of the law with which there are no courts in disagreement as an examination of the three circuit court opinions cited will disclose (R. 139):

> "While it might be well by statute to give the court some discretion in fixing the compensation of

[4] "The temptation, if a referee could thus increase his compensation, to err, would be too great. Serious questions involving his personal interest, upon which he would have judicially to pass, would be continually presented, and the result of such a system would soon be disastrous, and bring the courts of bankruptcy into disrepute. The objections to such an allowance are fundamental, aside from the fact that the compensation is fixed by law. To have the pay of a referee, acting in a purely judicial capacity, respecting a particular transaction, in which he acts for and on behalf of the court, measured by the extent of the fund that might be handled under and in pursuance of decrees and orders entered by himself, would be as anomalous as it would be unfortunate, because of the delicate and embarrassing position in which he would be constantly placed, as manifestly his personal and financial interest in what he was doing would frequently arise, and result in having his best motives impugned." *Bray* v. *Johnson* (C. C. A. 4, 1908), 166 Fed. 37, 60.

[5] *American Surety Co.* v. *Freed* (*In re Breakwater Co.'s Estate*) (C. C. A. 3, 1915), 224 Fed. 333, 339; reversing 220 Fed. 226.

a referee as was suggested *In re Columbia Cotton Oil & Provision Corporation*, 210 Fed. 824 [C. C. A. 4], it is impossible now to do anything but allow the arbitrary amount computed as the statute requires whether in given instances that be more or less than is reasonable. *Kinkead* v. *J. Bacon & Sons, supra*[6], [C. C. A. 6]; *McMillan* v. *U. S. Fidelity & Guaranty Co.*, 22 F. (2d) 135 [C. C. A. 8]."

This court again denied certiorari in a case arising from the second circuit in which it had been held that a referee in bankruptcy cannot be allowed for his services any compensation other than that provided for by the bankruptcy law or the general orders pertaining thereto.[7]

It is argued by petitioner (p. 14) that the opinion of Circuit Judge Chase "is in conflict with the principle approved by the third circuit in the *Freed* case, and with other cases involving claims for commissions".

Examination of the cases will disclose that no conflict exists. All circuits are in agreement that referees' fees are fixed and mandatory and regret the fact that the statute leaves no room for the exercise of judicial discretion. The *Freed* case, on its facts, is manifestly distinguishable from the case at bar. As stated by Judge Woolley, 224 Fed., at 339:

> "It was a transaction above, beyond and wholly outside of the bankruptcy court. If the referee and trustee had attempted such a thing as the recapitalization of the bankrupt's property and the issue and distribution of the stock of the new corporation, a claim for commissions, based upon the volume of indebtedness thereby discharged, would have been

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6 Certiorari denied, 241 U. S. 680.

7 *In re Meadows* (D. C. N. Y. 1912), 199 Fed. 304, at 309. Affirmed C. C. A. 2, 1914, 211 Fed. 948; certiorari denied *sub nomine, Hotchkiss* v. *Lynn*, 234 U. S. 763.

as fully without sanction of law as the transaction itself. If the same thing is done by others, the referee and trustee are no more entitled to commissions than if they had done the thing themselves.

We can find no authority in the law for an allowance of referee and trustee commissions upon such a basis. *It is to be regretted that there is no law authorizing* compensation to a referee and trustee proportionate to the difficulties encountered in administering an estate of the character of the bankrupt in this case."

The referee in that case was limited strictly to commissions on the assets disbursed. In that case, the assets of the bankrupt corporation were mortgaged to secure substantial claims and a plan was devised to preserve the bankrupt's property under which the assets were transferred to a new corporation, the secured and unsecured creditors to receive stock for their claims and in pursuance of the plan the assets were sold subject to the liens for a small sum. The decision, which is sound, limited the referee's commissions to the amount of actual cash paid to the estate for the assets. There is nothing in the opinion which even remotely suggests the existence of a conflict with the decision at bar.

The same observation applies to the statement of petitioners (p. 17) that *In re Mills Tea & Butter Co.*, 235 Fed. 815 (D. Mass.) "is in irreconcilable conflict with the decision sought to be reviewed". According to the facts of that case (p. 816) the creditors were offered an option of 25 per cent. cash or one hundred per cent. in the stock at par of a new corporation formed to take over the assets and business of the bankrupt. Some of the creditors accepted stock, others took the cash offer. The referee, in computing his commissions, figured *the*

stock as worth par. Judge Morton, in the *Mills* case, reversing the referee, properly held (p. 816):

> "Upon the case as it stands, the 25% cash, and the 100% stock, are to be regarded as *equivalents*."

This holding is, of course, justified on the facts. There was an option to creditors to take corporate stock or cash. There was a real basis of comparison. The case has nothing to do with the facts at bar which deal only with promissory notes. As Judge Morton observed:

> "It may be doubted whether there is any presumption that stock in a new corporation is actually worth par. Certainly such a presumption would be much weaker than in the case of promissory notes which are *absolute and certain obligations to pay money*" (p. 816).

Accepting stock in a corporation is altogether different from taking a direct promise to pay. In the first case, the stock is put at the risk of the business, participates in earnings and comes after creditors' demands.

In the *Mills* case there was at least a valid standard of comparison against which to measure the "equivalents". Here there is no alternative proposition. Creditors take the new promise and retain the old bond, with manifold new conditions thereon imposed, and as indicated by Judge Chase "because of the composition agreement they are to be altered in material respects" (R. 156, 7).

To refuse to accept the holding below will necessitate a declaration of a rule of law that in settlements where notes are offered, the referee's commissions shall be fixed only after computing the value of the bankrupt's notes. No authority declares such a proposition of law. The cases are to the contrary.

Indeed, no reasonable creditor accepts a bankrupt's note settlement with more than the hope rather than the certainty that it will be paid.

III.

Referee's compensation is notoriously inadequate. There is no basis for disturbing well settled and established precedent in what is necessarily an isolated and exceptional case because (a) the new Corporate Reorganization statute has rendered the question virtually moot and academic (b) the result in the case is avoidable under existing recognized practice.

The subject of bankruptcy and particularly referees' fees has been a matter of intensive study within recent years. Solicitor General Thomas D. Thacher, in a report prepared at the direction of President Herbert Hoover, has strikingly indicated that the compensation of referees is generally inadequate. His report commenting on "Meager Compensation and Lack of Incentive", with respect to total cases filed in 1930 indicates the fact not generally realized:

> "*Thus 95.8 per cent had assets of less than $5,000.* Two per cent had assets of from $5,001 to $10,000, 1.65 per cent had assets of from $10,001 to $50,000, *0.55 per cent had assets of over $50,000.*"[8]

It is evident that the case at bar involving substantial assets is an extremely rare occurrence, since more than 95 per cent. of the cases filed "had assets of less than $5,000." The instant case falls in a category which represents only *fifty-five one-hundredths of one per cent.* of the total cases filed. It therefore cannot be strenuously urged that the subject involved is of such general interest or wide application to warrant the necessity for a review under the present state of the law.

The report quoted, surveying the average compensation per annum of all the referees in the country based upon

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8 Strengthening Procedure in the Bankruptcy System, 86th. Doc. No. 65, 72d Cong., 1st Sess. (1932), at 7: referred to by this Court as the "Report of the Attorney-General" in *National Surety Co. v. Coriell*, 289 U. S. 426, 437, 438 (1932).

total compensation from all sources for the five fiscal years ending June 30, 1930, establishes that out of 501 full and part time referees, 60 per cent. averaged $2,000 or less per annum; 20% averaged $5,000 or less; 12% averaged between $5,000 and $10,000, and only 8% exceeded $10,000.[9]

The importance ascribed to the case by petitioners because it "affects almost all compositions" is on examination not justified by statistics, which establish that bankruptcy compositions are relatively rare, Solicitor General Thacher pointing out[10] that cases resulting in compositions represented but 1½ per cent. of the total number of cases filed in the five-year period ending 1930.

The suggestion that this case has added significance because of "depression times" is without substance in view of the creation by Congress of the new corporate reorganization statute, popularly known as § 77B,[11] enacted June 7, 1934, several months after the entry of the order approving the composition at bar (R. 101). In view of the greater flexibility of the new statute, it is extremely unlikely that any large company will again employ the rigid composition statute to effect a reorganization.[12] The new law may be further said in substantial cases to render the entire question of referees' compensation academic, for now, for the first time, by virtue of this amendment, Congress, with respect solely to corporate reorganizations under § 77B, has stated that the court may allow a referee in bankruptcy, sitting as a

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[9] Ibid. at 170, 171.

[10] Ibid. at 208.

[11] 11 USCA 207 (B).

[12] Weiner, 34 Col. L. Rev. 1—"* * * Section 77B has met with an instantaneous response on the part of reorganizers. In the brief time that has elapsed since its enactment last June, the path from equity receivership to proceedings in reorganization has been trodden into a broad highway." (Nov. 1934).

Gerdes, 12 N. Y. U. Law Quarterly Rev. 196, "Section 77B of the Bankruptcy Act sets up in the federal courts a system for the statutory reorganization of distressed corporations. (201) Prior to the enactment of 77B, the bankruptcy system did not afford adequate relief for corporations in financial difficulties." (Dec. 1934).

special master, "a *reasonable* compensation and reimbursement for his services and actual and necessary expenses".[13]

The cost of administration here involved is one of the bankrupt's own choosing, for, as Judge Thacher has pointed out, it is a "well-known fact that insolvent companies with very large assets are normally wound up or reorganized outside of bankruptcy, chiefly through equity receiverships".[14]

The company invoked the processes of this court by *voluntary* petition with full realization of the magnitude of the problems involved. It did not see fit to obtain a stay of adjudication[15] or to adopt the familiar devices employed by other large companies pending settlement with creditors to eliminate administration expenses by permitting the district judges to distribute the composition without the entry of an adjudication order. For instances in which that expedient was adopted and the question of referees' fees in that manner entirely eliminated, a distribution being made under the direction of a district judge, reference should be made to the stock brokerage settlement cases involving millions of dollars.[16]

In the case at bar, the bankruptcy court was not resorted to in order to escape burdensome obligations such as long-term leaseholds. The creditors are all unsecured note-holders (R. 7). Consequently, the entry of an adjudication order was not essential. Having invoked, presumably for valid reasons, the jurisdiction of this court, the voluntary petition indicating that it was filed at the inception of the proceeding "with a view to the offering of a composition in bankruptcy to its creditors" (R. 5), the

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13 77 (C) 11; 11 USCA 207 (C) 11.

14 Ibid. at 147.

15 "The practice exists, however, for in 8 out of 70 voluntary cases reported, stays of adjudication were permitted." Thacher, Strengthening Procedure in the Bankruptcy System, page 200.

16 See *In re Pynchon*, 63 F. (2d) 350; *Matter of Palmer & Co.*, 2 F. Supp. 275; *Guardian Trust Co. v. Stickle*, ancillary receiver of Prince & Whitely, alleged bankrupt, 63 F. (2d) 354, indicating these cases were administered as alleged bankrupts.

bankrupt should not now complain of conditions which it has itself created or endeavor to escape the burdens which necessarily arise from its own acts.

It is submitted that special law cannot be made to control large cases and that referees administering bankruptcy must be consistent and uniform in their practice. If any relaxation be necessary in the face of the new corporate reorganization statute, it is submitted a problem exists which invites congressional attention.

Petitioners suggest that (p. 8) "the possibility that a bankrupt corporation may be required to pay excessive fees[17] to referees and other officials interposes a serious obstacle to compositions under § 12 of the Bankruptcy Act and may discourage the use of the beneficent provisions of that section."

This possibility and apprehension is more fanciful than real as statistics and comments, *supra*, indicate. As recently as November 1934, it has been recognized that "there have been relatively few attempts to utilize §12 as a vehicle for corporate reorganization".[18]

IV.

The state of the record and the procedure followed by petitioners does not justify a review by this Court.

(a) Without in any wise conceding its materiality the Court should note that there is no competent proof in the record to establish the value of the bonds.

Creditors of the bankrupt approved of this settlement upon the representation that they would be paid in full (R. 62). After obtaining all the consents on that basis, it is suggested, for the purpose of computing the referee's com-

[17] The total administration expenses allowed in this case including maximum allowance to the referee is $154,928.93 against liabilities of $13,008,038.30, or slightly in excess of 1%. (See composition order R. 97, 98, 42, 43.)

[18] Friendly, Some Comments on the Corporate Reorganizations Act, 48 Harv. L. Review, 39, 48, (Nov. 1934).

missions, that creditors accepted a settlement which in fact did not include payment in full. In other words, the composition must be viewed in a double aspect, depending (1) on whether creditors' cooperation is being solicited, or (2) whether the expenses of administration are involved.

The attempted proof of the value of the bonds was not filed in the first instance before the referee at the time that the referee was accepting consents of creditors to a 100% settlement. It was submitted *for the first time* in the form of affidavits before the district court on the return date of the composition *after* the referee, as by rule[19] required, had certified the composition and reported the administration expenses (R. 65). The company was at the time of the submission of the affidavits in bankruptcy for nine months (R. 5, 65).

These affidavits, if proper proof, should have been filed in the first instance with the referee, together with all other papers on allowances in accordance with established practice.

It never has been the practice for the district court to take proof *de novo* on allowances; wherever new matter has been tendered, the question has been referred back to the referee, otherwise the certification is an idle ceremony and may as well be eliminated. See the circuit court's opinion on a prior appeal in this case "The court below properly remitted the proceeding to the referee in bankruptcy for further consideration by the creditors." 69 F. (2d) 44.[20]

In addition to the receiver's request for compensation the referee passed upon a number of other applications, among them the bankrupt's attorney and others (R. 294, 293, 126). Awards were recommended on the basis of the papers before the referee. These parties had their allow-

[19] Bankruptcy Rule 13 of the Eastern District of New York provides in part that "the referee shall certify: * * * 11. The expenses of administration, including fees * * * or other lawful expenses, * * *".

[20] Certiorari denied, *supra*.

ances recommended on one set of facts, while the referee was judged on another. It is to prevent that result that the Judges of the Eastern District created Bankruptcy Rule 10 on allowances:

> "10. All applications for allowances to receivers, trustees, appraisers, appointed by the Referee, accountants or attorneys *shall be filed in the first instance* with the Referee in Bankruptcy in charge of the case * * *."

(b) Having failed to take an appeal from the district court order the petitioners are barred from now urging that compensation should be computed only on the cash paid.

The argument made in that connection that the composition order did not operate as a discharge of all provable claims is so contrary to all established law that it is but necessary in reply thereto, to refer to Judge Chase's well-reasoned opinion and the decisions of this Court[21] therein cited (R. 157; fols. 471; R. 156, fol. 467).

CONCLUSION.

It is respectfully submitted that the petitioners have shown no reason in law or in fact which would justify this court in granting their petition for certiorari in this case, and that therefore, the petition should be dismissed.

Respectfully submitted,

GEORGE C. LEVIN,
Counsel for Respondent,
Eugene F. O'Connor, Jr.

SYDNEY KRAUSE,
GEORGE J. HIRSCH,
Of Counsel.

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[21] *Nassau Smelting & Refining Works* v. *Brightwood Bronze Foundry Co.*, 265 U. S. 269, 271 (1924). *Meyers* v. *International Trust Co.*, 273 U. S. 380 (1927).